Citizens Finance Review Commission

Budget Stabilization Fund: Cap Size and Other Issues

Prepared for the Citizens Finance Review Commission

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Introduction

The Arizona Legislature established the Budget Stabilization Fund (BSF), commonly known as the "rainy day fund," in 1990. It was designed to smooth out the fluctuations in Arizona's revenue streams, calling for payments to be made to the fund during periods of rapid state income growth and for funds to be paid out during periods of slowdowns or downturns. Although a wonderful idea, currently this fund is poorly designed to serve the needs of the state for five reasons.

First, money coming into the fund was limited to seven percent of the General Fund revenue at the end of each fiscal year. But, revenue streams frequently fluctuate by more than seven percent in a given year. Thus the limit of seven percent on a rainy day fund is too low to adequately cover one year of revenue fluctuations.

Second, the fund design does not account for slowdowns or downturns that cover more than one fiscal year. If a recession extends through two fiscal years, the rainy day fund will likely dry up during the first year, requiring severe cuts during the second (and often third) fiscal year of the recession.

Third, the funding formula, as altered in the mid-90s, can recommend $0 fund payout, even in severe recessions.

Fourth, the funding formulas were designed to smooth out revenue streams, but the design does not account for the increased demand for services that occur during difficult times.

Fifth, the fund was raided by the Legislature for purposes unrelated to fluctuations in the business cycle.

Background

The Budget Stabilization Fund (BSF), enacted in 1990 (A.R.S. § 35-144) and administered by the State Treasurer, is designed to set revenue aside during good times and to utilize this revenue during times of below-trend growth. The BSF could be an important tool for the fiscal management of the State of Arizona because a) states must maintain a balanced budget even during severe economic downturns, b) Arizona's revenue structure is extremely cyclical, partly because of its mix of revenue sources and partly because of the strong cyclicality of Arizona's economy, and c) the health and welfare component of state expenditures are counter-cyclical, increasing during difficult economic times and decreasing during strong growth periods.

The Arizona BSF is relatively unique in that it is formula driven. Only a few states have similar arrangements for their BSFs. Michigan was the first to have a formula driven BSF. The West Virginia BSF was modeled on the Arizona plan. While subject to

legislative appropriations for deposits and withdrawals, the BSF formula provides both a signal and suggested dollar amount for deposits to the BSF in "above average" economic times and fund withdrawals during "below average" economic times.

Current key features of the BSF fund can be summarized as follows:[1]

- The deposit into or withdrawal from the BSF for a given fiscal year is determined by comparing the annual growth rate of inflation adjusted Arizona Personal Income (AZPI) for the calendar year ending in the fiscal year to the trend growth rate of inflation adjusted AZPI for the most recent seven years.
- Adjusted personal income in the BSF formula is defined as total Arizona personal income less transfer payments, adjusted by the gross domestic product price deflator index.
- If the annual growth rate exceeds the trend growth rate, the excess multiplied by General Fund revenue of the prior fiscal year would equal the amount to be deposited into the BSF.
- If the annual growth rate is both less than 2% and less than the trend growth rate, the deficiency when multiplied by the General Fund revenue of the prior year would equal the amount to be withdrawn from the BSF.
- By a two-thirds majority, the Legislature, with the concurrence of the Governor, can decrease a deposit or increase a withdrawal.
- The BSF's total balance cannot be larger than 7.0% of the prior year's General Fund revenues.
- In addition to the fixed income investments available to the Treasurer, the 1998 Legislature allowed the Treasurer to invest up to 25% of the BSF in equity securities.

Diversions from the Original 1990 Design of BSF

There are several points that should be discussed regarding the current key features. Currently, the balance of the BSF is limited in size to 7.0% of the prior year's General Fund revenues. Under the original 1990 statute, the balance in the rainy day fund could reach as much as 15% of the General Fund budget before the transfers were stopped. The 15% size of the cap had been determined by examining prior business cycles and revenue collections. The original 15% figure had been established as the amount necessary to smooth Arizona's revenue flows through a modest recession. Despite the original determination of a 15% ceiling, the Legislature reduced the size of the cap to 5% in 1995, then gradually increased it from 5% in FY1997 to 7% in FY 2000.[2] Thus, at the start of the current major recession, the fund had a maximum balance that was well under half of what was intended in the original design.

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[1] This discussion is almost verbatim from the Arizona Legislature web site: http://www.azleg.state.us/jlbc/03app/bsf.pdf.

[2] Rex, Tom. "Public Finance in Arizona." Center for Business Research, L. William Seidman Research Institute, College of Business, Arizona State University, January 2003.

Another change that was made in the mid-1990s was the condition that withdrawals from the BSF would only be made if the annual growth rate in deflated adjusted personal income in the prior calendar year be below the trend line AND be below 2%. Supposedly, the 2% floor was added to avoid withdrawing monies when economic growth is slowing but there is not a recession, usually defined by negative economic growth. This requirement results in the formula rarely, if ever, recommending payouts from the fund to be made. The growth rate of real adjusted personal income will rarely fall below 2% because even during major recessions, Arizona's population growth commonly exceeds 2%. For example, the population growth rates for FY2000 through FY2003 were 3.774%, 3.145%, 2.769%, and 2.819%, respectively.[3] Thus it is likely that the formula may not have triggered any funds, let alone sufficient funds, even if monies were available.

Finally, the BSF was originally designed to be a management tool designed solely to smooth the fluctuations in the normal business cycles; it was not intended to be used as a contingency fund to cover legislated emergencies, such as the Alternative Fuels program, nor to finance needed capital expenditures, such as renovations to the Arizona State Hospital.

For FY2001 through FY2003, the BSF financed unplanned taxpayer refunds associated with Alternative Fuels of about $114 million, according to Joint Legislative Budget Committee records. In Laws 2000, 7th Special Session, Chapter 1 required that alternative fuel related liabilities would be funded by the BSF up to $200 million. The BSF was to be reimbursed by the General Fund at a rate of up to $16 million annually. However, this reimbursement provision was repealed.

Also, in 1999, the legislature allowed the BSF to provide for the majority of funding, $77.5 million, for major renovations to the Arizona State Hospital. This financing plan originally intended for the BSF to be reimbursed by Tobacco Tax Settlement funds. In fact, $40 million was repaid from that source to the BSF in FY2000 and FY2001. However, an Attorney General opinion related to usage of the Tobacco Tax Settlement funds caused plans for further repayments to the BSF to be cancelled. The unintended net cost to the BSF of the Arizona State Hospital has been $37.5 million to date.

As a result, the BSF has been used to finance a net $151.5 million for emergencies and projects that were completely unrelated to the economic downturn. Thus the state had only half (approximately) of the 7% capped BSF balance at the end of FY2001 to use to ease the budgetary problems of FY2002 through FY2004.[4]

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[3] The 2003 population growth rate is an estimate.

[4] The author wants to thank Kent Ennis, currently with CH2M Hill consulting firm, formerly with the Joint Legislative Budget Committee staff, for part of the background material and the figures for BSF outlays. Any errors in this section, however, are the sole responsibility of the author of this report.

Cyclicality of Revenues and Health and Welfare Expenditures

The main purpose of this report is to discuss the optimal cap size for the BSF, but the previous discussion highlights additional concerns associated with the BSF. In this section, cyclicality of revenues and health and welfare expenditures are discussed. Understanding the fluctuations of revenues and these "safety net" expenditure categories will shed light on the optimal cap size for the BSF.

Revenue Cyclicality

In this section, the size of the fluctuations of three major revenue sources will be examined: sales tax, individual income tax and corporate income tax. These three revenues comprise 94% of all tax revenue to the general fund. Fluctuations in these three revenues will be discussed both "nominally," and in "real per capita" terms.

The term "nominal" used in front of a word, such as revenues or dollars, simply means that no attempt has been made to adjust for the effects of inflation. A "nominal" dollar is worth less today than it was last year because inflation has eroded part of its purchasing strength. "Real" is a term used to describe dollars or revenues that have been deflated, or adjusted to remove the effects of inflation. A "real," or deflated dollar, by definition, has the same value today as it had last year. Thus, when discussing "real" revenues, the term means that the effect of inflation has been removed by adjusting with a price index (a Consumer Price Index, for example). When a percent change of "real" revenues is computed, it represents the change in purchasing power of those revenues.

"Real" revenues, divided by population, results in "real per capita" revenue figures. Economists frequently discuss "real per capita" revenues instead of "nominal" revenues because it makes it easier to identify business cycles, particularly in Arizona, where population growth can be strong even through recessions. In addition, it is important to recognize that the demands on the public sector grow with both inflation and population growth.[5] When utilities, equipment, supplies and communication costs increase, it affects the cost of doing business for governments as well as for firms in the private sector. When population increases, so does the demand for public services. School enrollments increase, court and correction caseloads increase, and health and welfare caseloads increase, even in the absence of a recession. Both inflation and population growth are powerful influences on the cost of running the government. When revenue growth falls short of the combined inflation and population growth rates, then there will be, almost by definition, cuts in government services. Thus, "real per capita" revenues, or revenues net

[5] For example, between FY2001 and FY2002, the Auditor General's Financial Report Highlights, June 30, 2002, indicated that education expenditures increased $135 million, or 4 percent, between fiscal years 2001 and 2002 as a result of rising student enrollment and inflationary increases in state aid to schools.

of inflation and controlled for population size, is a better indicator of the dollars governments have to work with.

Sales Tax Revenue Cyclicality

To examine the cyclicality of sales tax revenue, the tax base, i.e., taxable sales, was examined from FY1961 through FY2002. This long time-series is analyzed so that the economic downturns that occurred in the mid-70s, the early 1980s and the early 1990s can be examined, rather than just considering the most recent/current cycle.

The cyclicality of "taxable sales" was analyzed rather than actual collections because there were several tax rate changes throughout this period and taxable sales data are free of those changes. Taxable sales data are not free of changes made to the tax base, however. Sixteen taxable sales categories were added together to get "total" taxable sales for FY1981 through FY2002, for analysis purposes.

"Collection basis" taxable sales data were analyzed. When a sale is made, a tax liability immediately "accrues" to the state. This liability is paid a month later when the merchant sends a check to the Department of Revenue. Taxable sales figures "on a collection basis" means the sales figures correspond to month the payment is made, rather than the month the sale is made. Taxable sales data "on a collection basis" more closely matches actual revenue flows to the state than when sales are actually made.

Taxable sales, like most measures of economic activity, are strongly affected by changes in prices (inflation) and population growth. Thus, when nominal taxable sales are examined over time, the figures rarely show an actual decline. In the data series developed for this study, taxable sales declined by 2.3% in 1968, 6.95% in 1981, and 1.68 in 1983. The larger decline of 6.95% must be ignored because it corresponds to the 1980 exemption of food, which substantially reduced taxable sales the following fiscal year. Thus, inflation and population growth in Arizona tend to offset the fall in per capita purchasing power associated with recessions, with the exceptions in FY1968 and FY1983, in which nominal taxable sales declined by approximately 2%. In the most recent recession, sales tax revenues barely grew at all in FY2002 (0.6%) and only grew by approximately 1.8% in FY2003.[6] This slow growth occurred despite inflation increasing prices by 1.77% in FY2002 and 2.67% in FY2003 and population growing by 2.8% in both FY2002 and FY2003.

The cyclicality of taxable sales becomes much clearer when the figures are deflated and divided by population. When the resulting "real per capita" taxable sales are analyzed, very strong cycles are apparent. Total real per capita taxable sales can fall by as much as 12% (1975) or grow by as much as 18% (1969).[7] During periods of recession, the

[6] FY2003 growth figures are estimates for the year, based on data through May 2003.

[7] Again, the large decline in 1981 associated with the food exemption was ignored.

declines may be smaller but last for several years. Thus, the declines in real per capita sales from FY1988 through FY1992 were 4.1%, 1.3%, 2.4%, 4.4%, and 2.0%. The decline in any given year was not double digit, but the declines lasted multiple years and totaled 14% over the multiple-year period. Unfortunately a similar calculation cannot be made for the recession of the early 80s because the food exemption masks any recession-induced decline in 1981. However, it is telling that real per capita taxable sales fell by 6.1% in 1982 and 7.88% in 1983, for a total 14% decline over just those two years.

During the current recession, nominal taxable sales were flat in FY2002 (0.6% growth), while the combined growth in population and inflation was 4.6%. Thus, the state's ability to provide government services fell by 4%. In FY2003, sales tax revenues increased 1.8%, but the growth in prices and population growth was 4.9%.

Individual Income Tax Revenue Cyclicality

In nominal dollars, the individual income tax has shown two significant declines. In FY1991, individual income tax revenues fell by 16%, a figure larger than the 9% decline of FY2002. It should be noted that nominal individual income tax collections showed almost no growth in FY2003.

When inflation and population are controlled for, numerous fiscal years showed declines in real per capita individual income tax collections. During the weakness in the mid-70s, real per capita individual income tax revenues fell by 3.8% in 1975 and 2.9% in 1976. During the early 1980s recession, real per capita revenues from this source were virtually flat, showing no growth in FY1980 and FY1981. In FY 1985, there was a weakness in this revenue source, with real per capita individual income tax collections falling by 7.6%, according to Department of Revenue data.[8] In FY1991, part of the early 1990s recession, real per capita individual income tax collections fell by 22.2%.

During the most recent recession, real per capita individual income tax revenues fell by 13% in FY2002. Thus, the ability of these revenues to provide services fell by 13%.

Corporate Income Tax Revenue Cyclicality

The corporate income tax is the most volatile of the three major Arizona revenue sources. Nominal revenues from this source fell by 36% in FY2002, and are estimated to have grown 12% in FY2003, recouping a fraction of the FY2002 loss. The declines during the early 1980s and early 1990s recessions were smaller, dropping only 9% during FY1982 and 11% during FY1990. However, this revenue source showed substantial weaknesses in the mid-1980s, dropping 17% in FY1986 and 25% in FY1988.

[8] Department of Revenue (DOR) data was used for this analysis rather than JLBC data because the DOR data are available for a much longer period of time than the JLBC series. Sometimes there are differences between the two data series, but they are usually small.

Again, the volatility of this tax is much stronger when examined in real per capita figures. When inflation and the effects of population are removed, this revenue source fell by almost 15% in the mid-70s, by 3.4% in FY1981 and 18% in FY1982. The mid-80s weakness was much worse, with real per capita corporate income taxes falling by 5% in 1985, 22.8% in FY1986 and 31`% in FY1988. During the early 90s recession, revenues fell by 17% in FY1990 and showed no growth in FY1991. During the most recent recession, real per capita corporate income tax revenues declined by 38.5% in FY2002.

Revenue Mix and Cyclicality

The mix of state revenues can affect the volatility of a state's revenue structure. The mix of Arizona's revenue structure has changed over the last two decades in a way that has modestly increased revenue volatility. The share of the General Fund revenues derived from sales taxes remained relatively constant over the past two decades, representing 45.5% of the GF in FY1980, 44.1% in FY1990, and 46.9% in FY2000. With the passage of Proposition 301, the share associated with sales tax has increased to 49.9% in FY2003.

The sales tax is a less volatile revenue source than either the individual or the corporate income tax, so the slight increase in this tax source has slightly reduced the volatility of the tax structure. However, in FY1980 and FY1990, property taxes (general property taxes and the vehicle license tax) represented between 5.5% and 7.5% of the General Fund. By FY2000, however, these two property tax categories represented less than 1.5% of the General Fund. Property taxes tend to be the most stabile of all revenue sources because property values tend to hold even during a recession. At the same time, income taxes (personal and corporate combined) increased from 28.9% of the GF in FY1980 to 38.7% in FY1990, to 40.13% in FY2000. The loss of property tax revenue, the third leg of the traditional state tax structure, combined with the increase in the importance of the income tax, have increased the volatility of the tax structure over time.

Summary of Revenue Cyclicality

Of the three most important revenue sources to Arizona, the sales tax is the least volatile, showing annual nominal declines of 0 to 2% in any given year during economic slowdowns or recessions. The corporate income tax is the most volatile, with nominal losses during recession years between 10 and 36%. The individual income tax, while still very volatile, is more stable than the corporate income tax, has shown declines of 10% to 16% in economic downturns.

These figures represent the ranges of revenue declines for *one year,* the worst year, of a recession. Recessions are often characterized by a substantial slowing of growth, followed by a year of declining (negative growth) revenues, followed by a year of flat (zero growth) revenues.

This characterization fits the current/recent recession fairly well. In 2001, sales tax revenues grew by 5.5%, individual income tax revenues grew by 0.5%, and the corporate

income tax grew by 3.4%. The weighted average of these three major revenue sources grew by approximately 3.3% between FY2000 and FY2001. FY2002 suffered a 6.73% decrease in the big-three and revenue growth for FY2003 is expected to be approximately 2%. Revenues grew extremely slowly or declined between FY2000 and FY2003, despite the fact that population growth and inflation combined to increase 6.7% in FY2001, 4.6% in FY2002, and 5.6% in FY2003. Thus, for the past three fiscal years, revenues have severely fallen short of meeting the basic growth needs of the state.

Cyclicality of Health and Welfare Expenditures

It is extremely difficult to tell how much health and welfare costs and caseloads increase during a recession because usually these programs suffer significant cuts just at the times when these benefits are most needed. Ideally, to truly understand how these costs increase during a recession, data requirements include: a) the natural increase in health/welfare enrollment due to population and demographics and b) the increase in health/welfare enrollment due to an increase in the number of families qualifying for these services due to job loss or reductions in household income caused by the recession. This type of detailed data was not available for this report, so more general, secondary data sources were utilized.

To make analysis of the increase in health/welfare enrollment and costs even more difficult, Arizonans passed Proposition 204 during FY2002, which expanded eligibility in the program by raising the qualifying income for Arizona's health care system to 100 percent of the federal poverty level. According to the cover letter attached to the FY2002 Comprehensive Annual Financial Report of the State of Arizona, Proposition 204-related caseloads grew 200% during FY2002 and traditional Medicaid caseloads increased 21% during the year.

According to the Report Highlights of the Financial Report of the Office of the Auditor General of the State of Arizona, June 30, 2002, "Health and welfare expenditures increased $955 million or 21 percent between FY2001 and FY2002. The largest increase occurred in programmatic costs for the Arizona Health Care Cost Containment System (AHCCCS). These expenditures increased approximately $939 million, or 39 percent."

Continuing, this report stated: "A large increase in program membership and inflationary trends for health care cost has led to an increase in AHCCCS expenditures. … [T]he AHCCCS program membership increased by more than 172 thousand members, or 29 percent, during fiscal year 2002. The declining Arizona economy and increased enrollment due to the implementation of Proposition 204, a ballot initiative passed by voters on November 7, 2000 has led to this membership growth. The initiative expanded eligibility for the Title XXIX Medicaid program to 100 percent of the federal poverty level. Inflationary trends for healthcare costs are incorporated into the rate development process when determining capitation rates that the AHCCCS pays to healthcare providers. The capitation rate for the October 1, 2001, through September 30, 2002,

contract year was adjusted upward by approximately 7 percent to account for inflationary growth."

From this information, it is very difficult to tell what portion of the 29% increase in caseloads was due to Prop 204 and what portion was due to the recession. For purposes of this discussion, it is assumed that recession-induced caseloads accounted for one-third of the increase, or 10%. When this figure is combined with the 7% increase in inflationary agreements with providers, the resulting estimate of a 17% increase associated with the recession is not too dissimilar to a 13% nation-wide estimate of increases in Medicaid costs reported by the Council of State Governments.[9] Arizona's cost increase would be expected to be somewhat higher because of population effects and because Arizona already has most of its caseload in managed care, a shift other states are still making.

Since AHCCCS represents the bulk of the Health and Welfare portion of the General Fund and the Health and Welfare portion represents close to half of the General Fund expenditures, then we will assume that recession-induced demands on the general funds increased expenditures by approximately 8%, in FY2002.

Summary and Conclusions

The BSF, as currently designed, has failed to adequately serve the needs of the state. The fund is limited to 7% of the General Fund, but the three major sources of revenue – sales, individual income, and corporate income taxes – can fall by as much as 2%, 15% and 30%, respectively *per year*, during economic downturns. The weighted average of these as they are represented in recent fiscal years, implies that the big-three revenue sources can fall between 9% and 10% in one year during a recession, in nominal dollars. Since these revenue sources comprise 94 percent of all tax revenues to the General Fund, the seven percent limit is too low to adequately cover the potential revenue loss of even one year of a recession.

A 10% reduction in nominal revenues represents a 14% to 16% reduction in the state's ability to provide services to the ever-growing population in an increasingly expensive environment.

To make matters worse, recessions typically impact more than one fiscal budget. Recessions typically impact revenues for three years, showing slow growth one year, negative growth the next, and flat or slow growth the third year. Revenue growth that is less than the combined population growth and inflation, represents an erosion in "real per capita" state government revenues. As soon as state revenues fall below the combined

[9] Donald J. Boyd, "State Fiscal Conditions: 2003 and Beyond." The Council of State Governments, pp. 321-328.

growth in population and increases in the costs of providing those services, cuts in government service levels are the logical result.

Assume a typical recession that starts with a year of slow revenue growth that just meets population growth and inflation. In the second year, the recession may cause nominal revenues to drop by 9% to 10%, representing a drop in purchasing power of 14% to 15% due to population growth and inflation. In the third year of the recession, revenue growth may be flat, representing a 4% to 6% decline in government purchasing power.

The funding formulas are designed only to smooth out revenue fluctuations, not to account for recession-induced increases in the number of families qualifying for public support and health care. As estimated above, health and welfare expenditures associated with the recession may increase demands on the General Fund by 8%, including both increases in caseloads and increases in costs of services. This higher than normal expenditure level can last for multiple years. Increases in Arizona's healthcare and welfare caseloads typically are either voter mandated or formula driven.

The combination of volatile revenues, recessions that last more than one fiscal year, continued population growth and rising prices, and the burgeoning of families eligible for social services during a recession suggests that the Budget Stabilization Fund limit be increased to 30% to 35% of the General Fund. This range represents the sum of a one-year decline in nominal General Fund revenues of 9%, an extra 4% to 6% to account for population growth and inflation during that year, an additional 4% to 6% to account for population growth and inflation during the year that revenues are typically flat, and perhaps two years of significantly higher (8%) Health and Welfare expenditures.

It is important for voters, politicians and policy makers to understand that a fully-funded BSF will help not only the public/government sector during the next recession, but will help the entire state economy by acting as a strong counter-cyclical stimulus. The use of the BSF during a recession provides direct stimulus to the state by a) avoiding substantial reductions in the government sector at a time when other segments of the economy are weak and b) avoiding major cuts in health and welfare benefits that can have between a 1 to 1 and a 6 to 1 federal to state match. This federal flow of funds into Arizona can also act as a strong counter-cyclical force.

In addition to the current BSF fund cap being extremely low, there are other problems associated with the BSF.

It appears that the transfer formulas are too conservative to provide for substantial payouts during downturns. Clearly the "less than 2% growth" requirement should be removed from the formula. It was not in the original design of the BSF nor does it make sense. Even during severe economic downturns, Arizona's population continues to grow by 2% or more, making this requirement almost impossible to meet. The calendar year prior to FY2002 showed growth in adjusted deflated personal income greater than 2% due to strong population growth; thus, the formula would have triggered $0 in FY2002.

By deflating personal income to remove the effects of inflation in the formula, the resulting figures represent mostly population growth. Perhaps alternative formulas that compare per capita deflated personal income can be devised. The advantage of this type of alternative formula is that the resulting figures would pick up a recession faster. A major disadvantage of this type of formula is that accurate and timely population measures would be required.

While established to smooth fluctuations in state revenues, the BSF fund has been raided for unplanned expenditures not related to the business cycle. The state should establish a separate contingency fund that is designed to cover financial emergencies, such as the Alternative Fuels program or possibly major lawsuits that could significantly impact state expenditures. This contingency fund should be paid back in a promptly manner to assure it's availability in the next non-recession-induced crisis.

It would be desirable to have a state Constitutional Amendment that provides for the BSF and establishes guidelines for how the funds can be used.

A BSF is the best way to provide sound financial management in a very cyclical state with highly volatile revenue sources. There are very few alternatives to the BSF to solve the problems associated the business cycle and volatile government revenue sources. One would be to reduce the volatility of Arizona's revenues by reinstating the statewide property tax as a major source of revenue to the General Fund. Property taxes have a very stable base even in economic downturns. The volatility of Arizona's revenue structure has increased somewhat over the past two decades due to the reduced reliance on this stable funding source.

Another alternative would be that, in the future, excess revenue dollars be rebated back to taxpayers, rather than the Legislature passing permanent tax cuts during periods of rapid revenue growth. Three states, Colorado, Minnesota, and Oregon, rather than cutting tax rates, have rebated excess revenues to taxpayers during growth periods and shut down the rebate programs during the recession. The problem with this procedure is that it is similar to and has the same economic effect of raising taxes during a recession.

The BSF is an excellent tool for fiscal management. By smoothing revenue/expenditure flows during the business cycle, the BSF can not only reduce the havoc on government services created by severe economic downturns, but the BSF can act as a counter-cyclical force, both by maintaining state government spending levels during the recession and by attracting substantial federal dollars through its safety net programs.